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SUBJECT: A FIDESZ ECONOMIC PLAN DEVELOPS...BEHIND THE SCENES

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Classified By: Economic Officer Steven Weston, reasons 1.4 (b,d)

¶1. (C) Summary. Behind the scenes, the opposition Fidesz party is developing details of its economic program should the party win next April's national elections, as polls widely predict. The main thrust of the program will be to try to increase employment and economic growth through reforming and streamlining the public sector, restructuring the tax system, and launching a new economic program designed to promote small and medium-sized enterprises (SMES) and strategic industries, and help unskilled workers obtain training and jobs. Opposing views within the Party between those advocating substantial and immediate tax cuts to help stimulate the economy and those favoring a more fiscally cautious approach seem to be diminishing. In either case, a Fidesz government will likely seek to amend its agreement with the IMF and EU to raise deficit targets. In the run-up to April's elections, an increase in populist rhetoric on economic issues is likely, but senior Fidesz officials maintain that their criticisms will focus on the current government and its economic policies, and not the international business community in Hungary. Despite recent negative commercial cases in which Fidesz actors played a role, Fidesz officials assure us they understand the important role foreign investment and foreign companies play in Hungary's economy and its recovery. End summary.

A PROGRAM UNDER DEVELOPMENT...BEHIND THE SCENES

¶2. (C) Recent conversations with key Fidesz economic policymakers, including Parliamentary Budget Committee Chair and former Finance Minister Mihaly Varga, Parliamentarian and former Minister of Economy Gyorgy Matolcsy, former National Bank Governor and Finance Minister Zsigmond Jarai, former Deputy National Bank Governor Gyorgy Szapari and others, reveal that the development of a Fidesz economic program is underway, albeit behind the scenes. Publicly, Fidesz officials continue to discuss economic issues in only broad and sweeping terms.

¶3. (C) According to Matolcsy and others, the top priorities of the Fidesz economic program will be job creation and economic growth. To achieve this, they intend to move quickly to reform the public sector and ease the tax burden on both individuals and companies.

¶4. (C) Fidesz economic policymakers believe significant budgetary savings can be achieved by reforming the public sector through the elimination of outdated institutions, reducing the size of government, and decentralizing some of the tasks of the national government. They will propose halving the size of Parliament, decreasing the size of the public sector, and reducing the number of local government entities. They recognize, however, that many of their public

sector reform proposals would require a two-thirds majority in Parliament, which could present significant challenges depending on the make-up of Parliament following the elections.

¶5. (C) With the aim of promoting growth and making the business environment in Hungary more attractive, Zsigmond Jarai tells us that Fidesz plans to introduce a flat tax. Various rates have been mentioned, but tend to fall within the 18 - 20 percent range for both personal and corporate tax. Former (and likely future) Economy Minister Matolcsy favors a rate of 18 percent, so that it is "below the rate in Slovakia to help improve Hungary's regional competitiveness." Fidesz also plans to offer a tax deduction for families, in order to create incentives to address Hungary's declining population problem. Fidesz experts believe that a simplified tax system that reduces the tax burden for both individuals and companies will encourage greater reporting of income (thus reducing the size of the informal economy), produce higher VAT revenues through increased consumer spending, and promote increased economic competitiveness for Hungary.

¶6. (C) Matolcsy expects that the government would introduce a broad new economic strategy for the country by the middle of 2010, creating incentives for the development of SMEs and key industries, including environmental technology, automotive, clean energy, and health sectors. Regarding the environment, he foresees a plan to promote greater energy savings and the development and use of alternative and renewable energy sources, including nuclear, geothermal and solar energy. He sees potential for cooperation with U.S. and other strategic investors in these sectors.

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¶7. (C) Regarding Fidesz's promise for "one million jobs in 10 years", Matolcsy notes that much of the plan will involve finding work for Hungary's 1.2 million currently unemployed unskilled workers. In addition to increasing training in key areas like the health and technology sectors, he believes it is important to promote development of industries like agriculture, tourism and construction, which can employ larger numbers of less skilled workers. To encourage work, social allowances will be increasingly linked to work and education. He recognizes that many of Hungary's unemployed are Roma, and sees work and educational opportunities as keys to helping them break the cycle of chronic unemployment.

#### TAX CUTS FIRST, OR TOGETHER WITH SPENDING CUTS?

¶8. (C) Fidesz-oriented economist Peter Heim notes that there are two main schools of thought among Fidesz economic experts on the proper macroeconomic course for the country. One group, led by Gyorgy Matolcsy, favors substantial and immediate tax cuts to help stimulate the economy, even at the expense of higher budget deficits in the near term. The other view, generally associated with Zsigmond Jarai and others, favor a more fiscally cautious approach, in which tax cuts would be largely matched by cuts in spending. It seems that the gulf between these groups has narrowed recently, with the approach falling somewhere in the middle. We are often reminded by commentators both within and outside the party, however, that regardless of whether there are opposing views internally, ultimate decisions are made by Party President Viktor Orban.

#### FIDESZ AND THE IMF

¶9. (C) In private, Fidesz officials praise the IMF and give high marks to the approach the organization is taking in Hungary. Matolcsy and Jarai tell us that a Fidesz government would likely seek a new agreement with the EU and IMF when the current Stand-By Arrangement expires next October, and Matolcsy notes that "we would propose some changes" to the existing agreement. Among the changes, we expect Fidesz will seek slightly higher deficit targets in order to provide

greater stimulus to the country's economy, which they have already hinted at publicly. We are told that Gyorgy Szapari has been Fidesz's main interlocutor with the IMF. (Note: Mr. Szapari worked for the IMF from 1966 - 1993, including three years as the senior IMF representative in Hungary. End note.)

#### RHETORIC ON THE RISE

¶10. (C) As elections draw nearer, we anticipate that Fidesz campaign rhetoric will likely take an increasingly populist tone, as the party attempts to woo both voters leaning toward the far-right Jobbik party, as well as disaffected Socialist and smaller party supporters. Matolcsy told Pol/Econ Counselor that he does not expect campaign rhetoric to target the international business community, because "Fidesz understands the importance that foreign investment and international businesses play in Hungary's economic development." The primary target, he says, will be the economic policies of the current government, although he admits that "banks and bankers could become a target." He agreed, however, that reports on the negative Fidesz role in recent commercial cases like those involving U.S. Emmis Communications (REF A) and French Suez Environnement (REF B) can negatively impact foreign investors' views of the Party and Hungary as a place to do business.

#### COMMENT:

¶11. (C) Given the Party's concern about alienating any potential supporters, we expect that development of Fidesz's economic plan will continue primarily behind the scenes. As the elections draw nearer, in addition to increased criticism of the Bajnai government and its economic policies, we are not convinced the international business community will remain immune from attacks, particularly if the Party leadership believes it could help win votes. That said, other than the introduction of a flat tax, we do not expect a radical shift in economic policy in a Fidesz government. We expect, however, that Fidesz will test the limits of what investors and the IMF and EU will accept in terms of a higher deficit target for 2010 and possibly 2011 in order to fund tax cuts and provide stimulus to the economy. The key to whether Fidesz will be able to enact many of its planned public sector reforms lies in whether it achieves a two-thirds parliamentary majority, or whether it can cooperate on an ad-hoc basis with other parliamentary factions, which, according to current polls, would only

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include a significantly smaller Socialist faction and the far-right Jobbik party. While Matolcsy claimed that Fidesz would never work with Jobbik, he did not rule out cooperating with "more pragmatic" elements of the Socialist party. End comment.

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